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No. 89-54

IN THE

Supreme Court of the United States

October Term, 1989

NCR CORPORATION,

Petitioner,

vs.

COMMISSIONER OF REVENUE,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE SUPREME COURT OF MINNESOTA

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Where the application to a taxpayer of a 3-factor apportionment formula results in a difference in tax which is less than 23%, does the due process or commerce clause require that the property, payroll or sales factors of Petitioner, a Minnesota corporate taxpayer, include the property, payroll or sales of foreign subsidiary corporations from which it receives dividend or royalty income?

PARTIES INVOLVED

Petitioner is a Maryland corporation doing business in Minnesota. Respondent is the Commissioner of Revenue of Minnesota. Respondent is responsible for administration and enforcement of Minnesota's corporate tax.

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BRIEF IN OPPOSITION

The respondent Minnesota Commissioner of Revenue respectfully requests that this Court deny the petition for Writ of Certiorari seeking review of the decision of the Supreme Court of Minnesota in this case. The opinion of the Minnesota Supreme Court is reported at 438 N.W.2d 86 (Minn. 1989) and is reproduced in Appendix A to the Petition at 14a-32a (hereinafter referred to as "Pet. App.").

STATEMENT OF THE CASE

Petitioner is a Maryland corporation which transacts business partly within and partly outside of Minnesota. During the relevant tax years it received royalty and dividend income from foreign subsidiaries engaged in a unitary business with Petitioner. Those foreign subsidiaries file no returns in Minnesota and Minnesota does not tax them on the income they earn because they do no business in Minnesota. Minnesota does, however, tax Petitioner on its income, which includes the dividends and royalties it receives as payee from the payor foreign subsidiaries. For the five tax years at issue (1977-1981) Respondent therefore included in apportionable income dividends and royalties received by Petitioner from foreign subsidiaries which Petitioner had excluded from income in its returns as filed. Respondent's inclusion of dividends and royalties and also other income items not appealed from yielded an assessment of additional taxes for the five tax years 1977-1981 of approximately $216 thousand.

In its appeal to the Minnesota Tax Court from the assessment, Petitioner objected to inclusion of the dividend and royalty[1] income on the ground that it was not engaged in a unitary business with its foreign subsidiaries. Notice of Appeal, Pet. App. p. 40a.

Petitioner later abandoned this ground, conceded that it was engaged in a unitary business with its subsidiaries, Tax Court Finding of Fact ¶ 6, Pet. App. p. 20a, and reverted to an alternative ground for opposing the assessment which had been stated in its notice of appeal to the Tax Court. That

[1] There has never been any issue concerning interest income received by NCR from subsidiaries in this appeal. *See* Reasons For Denying The Petition § II.

ground was that various adjustments should be made to the property/payroll/sales factors of the Minnesota apportionment formula. Notice of Appeal, Pet. App. p. 40a.

Before the Minnesota Supreme Court, Petitioner made no specific proposals for adjustments but rather made a request for some unspecified "correlative adjustment" to its factors. *NCR Corp. v. Comm'r of Revenue*, 438 N.W.2d 86, 91 n.6 (Minn. 1989), Pet. App. pp. 23a-24a. Petitioner has never, at any stage of the appeal, provided a tax recalculation premised on its theory of how the factors should be adjusted which would identify how much its "correlative adjustment" would reduce the assessment. The tax impact of apportioning the dividend and royalty income was to increase Respondent's tax an average of 23% for the five year period at issue. *NCR*, 438 N.W.2d at 93, Pet. App. p. 28a. Because including the dividend and royalty income increased Petitioner's tax only 23%, any change resulting from a factor adjustment could not exceed that amount and is very likely substantially less.

REASONS FOR DENYING THE PETITION

Petitioner does not contend that the Minnesota decision conflicts with any decision of this or any other court. Instead, Petitioner seeks review under Supreme Court Rule 17.1(c), asserting that the case presents an important question of federal constitutional law. Petitioner further asserts that this issue affects many taxpayers, involves large amounts of income and has not been uniformly dealt with by State courts.

Petitioner's contentions are groundless and certiorari should be denied.

I. THE QUESTION PRESENTED IS NOT AN IMPORTANT QUESTION OF FEDERAL LAW WHICH HAS NOT BEEN BUT SHOULD BE DECIDED BY THIS COURT.

A. There Is No Lack Of Uniformity In State Court Decisions On The Issue Presented Nor Are The States Misapplying The *Container* External Consistency Test.

The argument in favor of granting certiorari first presented by Petitioner at pp. 10-13 and later revisited as an external consistency argument at pp. 20-23 is that if foreign dividends and royalties from unitary subsidiaries are apportioned then some unspecified "correlative adjustments" must be made to the factors of the recipient. This question Petitioner represents to be an important question of state taxation not previously resolved by this Court. It indeed has not been expressly resolved. Respondent disagrees, however, with the suggestion of Petitioner contained at pp. 10-13 that the Court "deliberately" left it unresolved or somehow reserved it for consideration in a future case. There never has been a

need to resolve it[2] and Petitioner has not demonstrated that there is a need to do so now.

Petitioner's primary assertion is that the issue is one on which states are not taking a uniform approach. It is noteworthy that Petitioner makes no claim that state courts have reached inconsistent conclusions on the issue presented. Even in this claim of "nonuniformity," however, Petitioner is wrong. What the very decisions cited at pp. 15-16 of the Petition show is that the States are taking a uniform approach. Their analysis is the same. They are simply reaching different conclusions depending on what the facts of the case show to be the amount of potential distortion occurring from application of the formula to the circumstances of the taxpayer.

Maryland, Wisconsin and Minnesota are all applying the external consistency test described in *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983) which requires that "the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated." *Container*, 463 U.S. at 169. The states are further recognizing the rule of this Court that since no apportionment formula is perfect, a "substantial margin of error" is afforded apportionment formulas. *Container*, 463 U.S. at 183-84. In *Container* the Court described a potential distortion of 14% to be a "far cry" from the 250% distortion arising from a one factor formula in *Hans Rees' Sons, Inc.*

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[2] In the cases mentioned by Petitioner, the issue was indeed referred to. There never has been a need to resolve it, however. The issue had not been previously raised in *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425 (1980). The facts did not present it in *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983). The cases were decided on other grounds in *ASARCO Inc. v. Idaho State Tax Comm'r*, 458 U.S. 307 (1982) and *F.W. Woolworth Co. v. Taxation & Revenue Dept.*, 458 U.S. 354 (1982).

v. North Carolina ex rel. Maxwell, 283 U.S. 12 (1931). *Container*, 463 U.S. at 184. *Hans Rees'* is the only case in which the Court has found impermissible distortion arising from an apportionment formula. The analysis of the states is the same. They are reaching different results on different facts.

In the Wisconsin case *American Telephone & Telegraph Co. v. Wisconsin Dept. of Revenue*, 143 Wis.2d 533, 422 N.W.2d 629 (Ct. App. 1988) the court held that on the facts of that case the formula did "not bear a reasonable relation to corporate activities"[3] of the taxpayer in Wisconsin and that the taxes were "grossly disproportionate to the benefits conferred"[4] by Wisconsin where the effect of including the income was by itself to increase apportionable income five times over that of the previous year (from $500 million to $3 billion).[5]

The Maryland Court of Appeals, in *NCR Corp. v. Comptroller of the Treasury*, 313 Md. 118, 544 A.2d 764 (1988), determined that the Maryland apportionment formula as applied to NCR should be modified *if* distortion of constitutional dimensions exists. The case was remanded for fact finding on the amount of possible distortion.

The Minnesota Supreme Court in its opinion in the instant case made the same type of *Container* analysis. It concluded on the facts that the distortion which could be argued to result from the Minnesota formula was not of a size to be constitutionally objectionable. *NCR*, 438 N.W.2d at 93, Pet. App. pp. 27a-28a. The exact amount of the alleged distortion resulting from Minnesota's refusal to adjust Petitioner's factors is, of course, not known since Petitioner never pro-

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[3] *American Telephone & Telegraph Co. v. Wisconsin Dept. of Revenue*, 143 Wis.2d 533, 422 N.W.2d 629 at 636 (Ct. App. 1988).

[4] *Id.*

[5] *Id.*, 422 N.W.2d at 634.

vided to the Minnesota Supreme Court a specific correlative adjustment proposal nor a tax recalculation premised on it. Respondent asserts there is no distortion at all. However, the *total* effect of *including* the dividend and royalty income in apportionable income with *no* factor adjustment was approximately 23%. The effect of failing to adjust the factors as Petitioner desires must be even less than that (substantially less, Respondent suspects). If the Minnesota formula can be said to result in distortion, surely, a level of distortion of less than 23% is constitutionally permissible. Petitioner at p. 10 n.6 suggests 40 or 50%. Even were it as high as 50%—a figure rejected by the Minnesota Supreme Court, *NCR*, 438 N.W.2d at 93, Pet. App. pp. 27a-28a,[6]—this is still insubstantial because it is a far cry from the 250% rejected in *Hans Rees'*.

Consequently, Petitioner's assertion of a lack of uniformity does not withstand analysis.

Petitioner argues at pp. 20-23 of the Petition that the fact-based approach used by Minnesota, as well as Wisconsin and Maryland, to measure whether the potential difference in taxes exceeds a constitutionally acceptable level is improper. It asserts that the Minnesota formula is structurally or conceptually defective. Each of the reasons Petitioner advances in support of this proposition is fallacious.

First, Petitioner argues that Justice Stevens' dissent in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 449-62 (1980), establishes that inclusion of dividends from foreign subsidiaries in apportionable income without inclusion of the subsidiaries' property, payroll and sales in the formula vio-

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[6] It was rejected because it was based on a number of faulty premises. For example, Petitioner includes interest income in the calculation even though no interest income issue was raised in its Notice of Appeal. *See* Pet. App. p. 40a.

lates the external consistency requirement. On the contrary, Justice Stevens' language in *Mobil* is consistent with the State's fact-based approach to this issue. Justice Stevens' dissent must be understood in the context of the facts of the case, in which he observed that in his view "Vermont indefensibly used its apportionment methodology artificially to multiply its share of Mobil's 1970 taxable income perhaps as much as tenfold." *Mobil*, 445 U.S. at 461. In this context he wrote in a dissenting opinion that:

> Unless the sales, payroll and property values connected with the production of income by the [dividend] payor corporations are added to the denominator of the apportionment formula, the inclusion of earnings attributable to those corporations in the apportionable tax base will inevitably cause Mobil's Vermont income to be overstated.

Mobil, 445 U.S. at 461. He was not opining that in *all* cases the standard three factor formula is defective and must be restructured if foreign source income is apportioned. If it were compelled in all cases, the Court would be specifying one formula for use by all states contrary to the firmly established policy of the Court that "the Constitution imposes no single formula on the States," *Container*, 463 U.S. at 164, and contrary to the policy of wide latitude afforded states in structuring their formulas, *see Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 274 (1978) (one factor formula upheld).

Second, there is surely no "conceptual inconsistency," as suggested by Petitioner at p. 22 of the Petition, in Minnesota's formula because it does not include in the factors of a Minnesota taxpayer the property, payroll and sales of other corporations which do no business in Minnesota and file no returns in Minnesota. As observed by both the Minnesota Court, *NCR*,

438 N.W.2d at 92, Pet. App. p. 25a, and the Maryland Court of Appeals in *NCR Corp. v. Comptroller of the Treasury*, 313 Md. 118, 544 A.2d at 772, this "consistency" contention is premised on confusion over who and what is being taxed. Minnesota is not taxing the income earned by the foreign subsidiaries. It is only taxing income (dividends and royalties) earned and received by Petitioner. It makes no conceptual sense to require inclusion, in Petitioner's apportionment formula, of factors of corporations whose income is not being taxed. To include them merely expands the denominator of the formula, distorting it.

Third, in support of its consistency argument Petitioner suggests at p. 21 that Minnesota's method must be invalid because Petitioner's apportionable income would be changed were it to operate through branches of the parent corporation in foreign countries rather than independent subsidiary corporations. This is surely no revelation demonstrating a deficiency in the Minnesota formula. The form of corporate organization chosen by a taxpayer does have tax consequences. Indeed, the method of corporate organization is often solely intended to achieve certain tax purposes.

The very example suggested by Petitioner—of a corporation doing business itself in a foreign country (through a branch) compared with one having a subsidiary in the foreign country—gives proof to this point. If the corporation chooses the former method of corporate organization (doing business itself through a branch rather than setting up a subsidiary), Minnesota would tax the appropriate portion of *all* the income earned by the corporation, including that income earned by the branch in the foreign jurisdiction. If the corporation chooses the latter form of organization (as has Petitioner), Minnesota would include in apportionable income, and therefore tax, only

such distributions as actually were made to the parent corporation. It would not tax the underlying income earned by the subsidiary in the foreign jurisdiction. By choosing to separately incorporate its foreign subsidiaries, Petitioner has shielded their foreign income from Minnesota taxation. Petitioner should not be allowed to have its cake and eat it too by being allowed to reshape the apportionment formula to include its subsidiaries' factors.

B. The Question Presented Does Not Have The Significance Which Petitioner Suggests.

Petitioner asserts at pp. 13-14 of its Petition that the question presented affects taxpayers in nearly every state and many local jurisdictions and involves billions of dollars of foreign source earnings. The facts and data it offers in support of the statement show no such thing.

Petitioner asserts an effect on numerous taxpayers because of an alleged "common practice" to apportion foreign source income without somehow adjusting the factors. The very decisions cited by Petitioner show the contrary. The taxpayer in the Wisconsin case prevailed and the Department of Revenue was ordered to determine a formula that would achieve constitutional results, although the request for the particular factor adjustment requested by AT&T was rejected by the Court. *AT&T*, 143 Wis.2d 533, 422 N.W.2d at 636-39. NCR in the Maryland case will get a factor adjustment if it proves significant distortion. The Minnesota Court did not rule one out in a case of significant distortion. The decisions show that adjustments are being ordered where appropriate.

At least one state provides factor adjustments by statute[7] when foreign source dividends are apportioned. Moreover, most states have a statute similar to Minn. Stat. § 290.20, subd. 1 (1988) which provides:

> The methods prescribed by section 290.191 shall be presumed to determine fairly and correctly the taxpayer's taxable net income allocable to this state. If the methods prescribed by section 290.191 do not fairly reflect all or any part of taxable net income allocable to this state, the taxpayer may petition for or the commissioner may require the determination of net income by the use of another method, if that method fairly reflects net income. These other methods may include:
>
> (1) separate accounting;
>
> (2) excluding any one or more of the factors;
>
> (3) including one or more additional factors; or
>
> (4) some other method.
>
> . . . .

Section 18 of the Uniform Division of Income for Tax Purposes Act (UDIPTA) and Multistate Tax Commission Compact art. IV, § 18 are nearly identical. Respondent believes that the states do consider factor adjustments under such statutes to deal with circumstances where applications of the regular formula would yield a distorted result and not be fair.

The statement at p. 14 of the Petition that there are many state disputes involving the issue presented and the statement at p. 16 that the Court should address the issue to avoid widespread administrative and judicial proceedings is belied by the fact that in the eight years since Justice Stevens' dissenting opinion in the *Mobil* case, only three state cases on this

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[7] *See* Utah Code Ann. § 59-7-303(4) (1987).

constitutional issue have been litigated—the instant case, and the two cited on p. 15 of the Petition. However interesting the issue may be to Petitioner, who evidently has filed appeals on the issue in 44 states, it cannot be said to have been a subject generating a great deal of litigation. Consequently, Petitioner's generalities about common practices and their effects on taxpayers in a number of states do not withstand scrutiny.

The actual data offered by Petitioner to suggest that the magnitude of the impact of the question presented is billions of dollars is misleading in several respects. First, it does not show the tax impact of the issue presented. Petitioner has not presented any data showing the amount by which taxes will be reduced if correlative adjustments are allowed. Petitioner instead offers aggregate amounts of receipts of dividends, interest and royalties from U.S. controlled foreign corporations. Petition pp. 13-14 n.7. The propriety of including the income is conceded by Petitioner and is not at issue. Factor adjustments are at issue. Petitioner never, however, offers data on the tax impact of requiring factor adjustments, either in the form of aggregate data or in the form of a tax recalculation on the facts of the instant case.

Taking the example of the instant case, Respondents believe the effect is minimal. The total effect of apportioning Petitioner's dividends and royalty income for all of the 1977-1981 tax years was to increase its tax only about 23%. And, it must be remembered, the effect of adjusting factors has to be even less than the effect of including the foreign source income itself. Petitioner asserts at p. 10 n.6 that the number is 40% in 3 of 5 years and 50% in one year by including interest income in its calculation which type of income is not at issue. Even were the number as high as 50%, which again is not the impact of Petitioner's unspecified factor adjustments but is rather the tax impact of apportioning the income, such a

number is still within the permissible margin of error for a formula.

In addition to the fact that Petitioner's data does not address the question presented, the data offered is misleading because it overstates the magnitude of the question in several ways. First, much of the dividend income is not taxed by the states. Petitioner alludes to 1980 IRS data showing approximately eleven billion dollars in dividends paid in 1980 by controlled foreign subsidiaries to U.S. corporations. However, not all states tax foreign source dividends. Eleven states[8] exempt foreign source dividends from taxation and 19 more states[9] substantially exempt them.[10] Minnesota itself gave an

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[8] *See e.g.* Ariz. Rev. Stat. Ann. § 43-1122(8) (Supp. 1988); Conn. Gen. Stat. Ann. § 12-217(a)(D) (West 1983); Del. Code Ann. tit. 30 § 1903(a)(2) (1985); Fla. Stat. Ann. § 220.13(1)(b)2a (West 1989); Ga. Code Ann. § 48-77-21(b)(8) (Supp. 1988); Ky. Rev. Stat. Ann. § 141.010(12)(b) (Michie/Bobbs-Merrill Supp. 1988); Mo. Rev. Stat. § 143.431 (Supp. 1989); Neb. Rev. Stat. § 77-2716(3) (1986); Ohio Rev. Code Ann. § 5733.04(I)(2) (Page's Supp. 1988); Pa. Rev. Stat. Ann. tit. 72 P.S. § 7401(3)1(a)&(b) (Purdon's Supp. 1989); W. Va. Code § 11-24-6(c)(10) (Supp. 1988).

[9] *See e.g.* Ark. Stat. Ann. §§ 26-51-404, 26-51-707 (1987); Cal. Rev. & Tax Code § 24411 (Supp. 1989); Col. Rev. Stat. §§ 39-22-304, 39-22-303(10) (Cum. Supp. 1988); Idaho Code § 63-3027C (1989); Ill. Rev. Stat. Ann. Ch. 120 para. 2-203(b)(2) (Smith-Hurd 1974); Ind. Code Ann. § 6-3-2-12 (West 1989); Kan. Stat. Ann. § 79-32,138 (c)(iv) (Cum. Supp. 1988); Md. Tax-Gen. Code Ann. § 10-307(b) (1988); Mass. Gen. Laws Ann. ch. 63 § 38(a) (West 1988); Minn. Stat. § 290.21 Subd. 4 (1988); Mont. Code Ann. § 15-31-325 (1987); N.J. Rev. Stat. § 54:10A-4(k) (1986); N.Y. Tax Law § 208.9(a)(1) &(2) and (b)(2)&(3) (McKinney 1986); N.D. Cent. Code § 57-38-01.3 (Supp. 1989); Or. Rev. Stat. § 317.267 (1983); Tenn. Code Ann. § 67-4-809 (1983); Utah Code Ann. §§ 59-7-106(2)(d), 59-7-303(1) (1987); Va. Code Ann. §§ 58.1-402C, 58.1-302 (Supp. 1989); Wis. Stat. Ann. § 71.04(4) (West 1989).

[10] Even the chart presented in Petitioner's Appendix (pp. 48a-50a) shows that 21 states do not tax dividends at all or exclude them from apportionable income. Many states that do tax them provide deductions for dividends paid by affiliates. *See* Pet. App. p. 50a n.2.

85% credit (exemption) for the tax years at issue. *See* Minn. Stat. § 290.21, subd. 4 (1980). Many other states give an exemption of similar magnitude.[11]

Second, the data offered overstates the tax impact of the issue presented because it includes more than income received by U.S. corporations from unitary foreign subsidiaries. The IRS data is on all controlled corporations whether or not they are corporations unitary with a U.S. parent. *See* 26 U.S.C.A. § 957(a) (1988). Whether a corporation is unitary with its parent depends on facts unique to each parent and subsidiary. Similarly, the Commerce Department data, Petition pp. 13-14 n.7, is not data on foreign source income paid by unitary foreign subsidiaries to U.S. parents. Like the IRS data, it is more inclusive than data on foreign source income paid to U.S. parents by unitary subsidiaries. The data consists of aggregate data on any U.S. company having investments abroad amounting to more than a 10% shareholder interest whether in a unitary foreign subsidiary or not. 15 C.F.R. ch. VIII, § 806.14(a) (1988). Therefore since the data presented is not limited to data on foreign source income received by U.S. corporations from unitary foreign subsidiaries it overstates the significance of Petitioner's issue.[12]

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[11] *See e.g.* Idaho Code § 63-3027C (1989); Ill. Rev. Stat. Ann. ch. 120 para. 2-203(b)(2) (Smith-Hurd 1974); Ind. Code Ann. § 6-3-2-12 (West 1989); Or. Rev. Stat. § 317.267 (1983).

[12] The Commerce Department data also overstates the magnitude of the tax issue in the instant case in other ways. Petitioner cites that data to show an aggregate $27.73 billion in dividends, interest and royalties paid in 1987 by foreign affiliates to domestic parents. First, "distributed earnings" (which includes dividends) represent $19 billion of this amount, which as observed above is completely or substantially exempt from taxation in many states. Second, what Petitioner characterizes as dividends is really presented in the data as "distributed earnings." U.S. Department of Commerce, Bureau of Economic Analysis, Survey of Current

Respondent submits therefore that Petitioner has made no attempt to identify the monetary impact of the actual tax issue presented (factor adjustments). Further, because of exemptions in many states of what is clearly the biggest income item (dividends) and deficiencies in the data which it does present, the tax impact of the issue presented is surely substantially less significant than intimated by Petitioner.

C. The Due Process Internal Consistency Analysis Presented By Petitioner Is Flawed.

At pages 18-20 of the Petition it is asserted under the *Container* due process internal consistency test that it is a *mathematical certainty* that not adjusting factors inevitably results in more than all of Petitioner's income being taxed. Petitioner is wrong in both its legal analysis and its mathematics.

The legal analysis is flawed because Petitioner has misapplied the internal consistency analysis. To be internally consistent, the apportionment formula must not result in more than all of a unitary business's income being taxed if applied by every jurisdiction. In *Container*, the Court described the test:

> The first, and again obvious, component of fairness in an apportionment formula is what might be called internal consistency—that is, the formula must be such that, if

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Business, Vol. 68, number 6, 55 at line 5 (June 1988) and Vol. 69, number 3, 46 (March 1989). Distributed earnings is not limited to dividends but rather also includes such payments as distributions from partnerships and trusts and resulting profits of any type including those arising from ownership of commercial real estate and unincorporated businesses. *See* 15 C.F.R. ch. VIII, § 806.7(i) (j) and (k) (1988) (defining types of investment covered by data).

> applied by every jurisdiction, it would result in no more than all of the unitary business income being taxed.

Container, 463 U.S. at 169. The formula, in other words, must not result in multiple taxation of the same income by different jurisdictions. Petitioner and Respondent differ on what the relevant taxing "jurisdictions" are under this test.

Petitioner apparently argues that the internal consistency requirement is violated if multiple taxation occurs as a result of taxes imposed by foreign nations. Respondent's position is that the U.S. Constitution can only mandate internal consistency among the taxing jurisdictions within the United States.

Petitioner contends that it is subject to tax in jurisdictions in which it does business (which it calls NCR jurisdictions) and also subject to a tax by what it calls Foreign Jurisdictions on the dividends and royalties which it expatriates to the United States. An example is a tax charged by Canada which is described at p. 26 n.15 of the Petition as an income withholding tax imposed on NCR.[13] Petitioner contends that use of the Minnesota apportionment formula, as applied here, in all "NCR jurisdictions," combined with taxation of the same foreign source income by the foreign jurisdictions would inevitably result in multiple taxation. That contention is irrelevant for internal inconsistency purposes.

Petitioner's construction of the internal consistency test cannot be correct, because it would be impossible to satisfy. The internal consistency test requires that a formula, if applied by *all jurisdictions*, would not cause multiple taxation.

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[13] *See* Income Tax Act of Canada §§ 212(1)(b), 212(1)(d), 212(2) which imposes a tax on dividends paid a nonresident by a Canadian corporation, which tax is withheld by the Canadian corporation.

The Minnesota apportionment formula[14] assures that if all *states* apportion a taxpayer's income on that basis, 100%, but no more than 100%, of the income would be taxed. However, if taxation of the same income by foreign jurisdictions, not subject to the strictures of the U.S. Constitution, is also considered, it is an impossibility to guarantee that multiple taxation will not occur. In fact, if taxation by all states and even one foreign jurisdiction is assumed, multiple taxation is, as posited by Petitioner, a virtual certainty.[15] Plainly, the Court cannot have intended its internal consistency test to be one that can never be satisfied. Accordingly, evaluation of an apportionment formula for internal consistency must necessarily take only state taxation into account, excluding consideration of the potential impact of foreign taxation.[16]

Indeed, the only way to insure that no multiple taxation could result from the combined effect of taxation by the states as well as foreign jurisdictions would be to prohibit taxation of foreign source income entirely. The Court has already rejected that approach in *Mobil* and *Container*. Respondent

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[14] Income of taxpayer x

$$\frac{\text{Taxing state property/payroll/sales of taxpayer}}{\text{Total property/payroll/sales of taxpayer}}$$

[15] This is so even if the foreign subsidiary's property/payroll/sales are included in the denominator of the formula, because use of the formula by all states would result in 100% taxation. The foreign jurisdiction, unencumbered by the strictures of our Constitution, remains free to tax any or all of the same income paid by the foreign subsidiary.

[16] Respondents observe that even if the internal consistency test were applied to foreign taxing jurisdictions, the Minnesota formula would pass the test. If it were assumed that the relevant taxing jurisdictions consisted of the states and also all foreign jurisdictions and that if the inquiry was whether if all of these jurisdictions used the Minnesota formula multiple taxation would occur, the answer would clearly be no. Under the Minnesota formula it would be impossible.

observes in this vein that Petitioner has been careful to make no attempt to describe how and why its correlative adjustment will remedy what it perceives to be an internal consistency problem.

By attempting to inject the effect of foreign jurisdiction taxation into the internal consistency analysis, Petitioner is really objecting to international multiple taxation, about which the internal consistency test can say nothing. More properly, Petitioner's analysis of the effect of combined state and foreign taxation should be made under the foreign conmerce clause. Indeed Petitioner does at pp. 23-27 of the Petition (discussed below in section I.D.) make the very same argument as a foreign commerce clause argument. Petitioner's legal analysis in which it attempts to shoe-horn that argument into the internal consistency test is, however, fatally flawed.

Just as with Petitioner's le[illegible]l analysis, its mathematics are flawed. Even were we to accept its contention as a legitimate internal consistency analysis, Petitioner's failure to include in its calculation the federal foreign tax credit should invalidate its approach. The federal returns of NCR show it received a credit on its federal income tax return on most if not all of the taxes it paid foreign governments on foreign source income it received. *See* I.R.C. § 901, 26 U.S.C.A. § 901 (Supp. 1989) (foreign tax credit). The returns of NCR contained in the case record show that it included the tax which it paid Canada in its calculation of the foreign tax credit. *See e.g.* 1980 federal return, Form 1118 (and supporting schedules) and Form 1120 Schedule J. Petitioner's mathematics are therefore to be rejected since such actual double taxation which hypothetically might exist is eliminated by the federal foreign tax credit.

D. The Foreign Commerce Clause Argument Of Petitioner Was Effectively Rejected By This Court In *Mobil* And *Container*.

At pp. 23-27 of the Petition it is asserted that the foreign commerce clause is violated unless Minnesota makes some correlative adjustment to its statutory formula. It is asserted that international double taxation otherwise results because foreign countries have a primary right to tax dividends and royalties paid to a nonresident. The income withholding tax imposed by Canada on dividends and royalties paid by the Canadian subsidiary is given as an example at p. 26.

Respondent submits that this argument was rejected *a fortiorari* in *Mobil* and *Container* where the Court rejected foreign commerce clause arguments opposing inclusion of foreign source income in apportionable income. Because the factor adjustments proposed by Petitioner are issues involving a tax impact which is necessarily less than the impact of apportioning the income itself the issue presented has even less foreign commerce significance than the issue decided against the taxpayers in *Mobil* and *Container*. Petitioner's argument should therefore be considered included in the arguments rejected in *Mobil* and *Container*.

In both *Mobil* and *Container*, the taxpayers sought to extend the holding of *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), concerning a property tax levied on containers used in foreign commerce, to an income-based tax. This Court refused to do so in *Mobil*, where the taxpayer asserted that taxation of foreign source dividends should be restricted to the taxpayer's domestic domicile lest double taxation result because of taxes levied by foreign countries. The Court similarly rejected in *Container* a foreign commerce clause challenge to California's worldwide formulary apportionment tax-

ation of foreign subsidiaries. The argument was that double taxation of the income of the foreign subsidiaries would result if California apportioned part of the income of those subsidiaries to the parent, because the income of the subsidiaries was taxed under separate accounting (100% taxation, non-apportioned) in their home (foreign) jurisdictions.

The Court in *Mobil* observed that "the factors favoring use of the [international] allocation method in property taxation have no immediate applicability to an income tax." *Mobil*, 445 U.S. at 448. Again in *Container* the Court refused to extend the holding of *Japan Line* to an income-measured tax, finding that there are significant differences between income-based and property taxation for foreign commerce clause purposes. *Container*, 463 U.S. at 187-88.

Foreign commerce clause arguments were rejected in both of these income tax cases for very practical reasons; to wit, since this Court has no control over foreign governments it cannot assure that double taxation may not occur by reason of their actions in the way it can assure that the actions of the various states do not result in double taxation.

The foreign commerce clause should therefore provide Petitioner no solace in the instant case. Consistent with this, how and why a correlative adjustment (whatever it may be) will prevent international double taxation is not revealed by Petitioner. The only way to assure against double taxation is to prevent taxation of foreign source income entirely—a result rejected in *Mobil* and *Container*. Multiple taxation is no more inevitable in the instant case than in *Mobil* or *Container* and logically is *less* since the correlative factor adjustment Petitioner has in mind will surely have less impact on tax paid than including the income itself (the issue in *Mobil* and *Container*).

At p. 27 of the Petition it is asserted that Minnesota's failure to adjust Petitioner's factors prevent the United States from speaking with one voice in regulating foreign commerce. Petitioner offers no evidence at all of any federal policy with which the Minnesota Supreme Court opinion is in conflict. This is consistent with the express rejection of the taxpayer's similar argument in *Container*. *See Container*, 463 U.S. at 193-97.

The proffered foreign commerce clause question was therefore effectively resolved by this Court's opinions in *Mobil* and *Container* and is not one on which this Court need rule in this case.

II. THE RECORD IN THIS CASE DOES NOT SUFFICIENTLY PRESENT THE ISSUE RAISED BY PETITIONER.

The deficiencies in the record are several. First, Petitioner has proposed neither to the Minnesota Supreme Court nor to this Court a specific proposal for the "correlative adjustment" which it seeks. Moreover, Petitioner has never provided any tax recalculation under the method of adjusting the factors it proposes. The Minnesota Supreme Court itself commented on this deficiency in its opinion:

> In its brief and at oral argument, relator was unable to more precisely define what it contended should be included in this "correlative adjustment." During the course of this proceeding, NCR has seemingly shifted its position on this issue, lending some support, in our view, to the Commissioner's contention that selection of an apportionment formula is essentially one of policy for legislative resolution.

NCR, 438 N.W.2d at 91 n.6, Pet. App. pp. 23a-24a. If this Court should ever take up this issue, which Respondent believes is unlikely for the reasons stated above, it should do so on a more complete factual record dealing with specific proposals for adjusting a state's formula.

The second deficiency in the record is that although Petitioner in the question presented refers to interest received from foreign sources as part of that which is in issue, foreign source interest has *never* been an issue in this case and cannot therefore become one now. The Notice of Appeal of Petitioner to Tax Court raises no issue at all concerning foreign source interest. *See* Pet. App. p. 40a. This is reflected in the Tax Court's Statement of the Issue which refers only to dividends and royalties. *See* Pet. App. p. 6a. Petitioner concedes so. Petition pp. 7-8 n.5. The Minnesota Supreme Court similarly observed interest was not in issue and confined its discussion to dividends and royalties. *NCR*, 438 N.W.2d at 87 n.1, Pet. App. p. 16a. The statement in footnote 5 of the Petition that the case was somehow "presented" to the Minnesota Supreme Court on the interest issue cannot possibly be true. Amounts of interest were stipulated to as matters of fact. The Notice of Appeal, however, defines and limits the issues raised to dividends and royalties.

Third, Petitioner has asserted as part of its internal consistency argument at p. 19 n.11 of the Petition that it paid approximately $41.5 million in foreign withholding taxes, such as those it paid Canada. This amount is also alluded to at p. 3 n.2 of the Petition in which Petitioner asserts that these amounts were "derived" from federal income tax returns attached to the Minnesota returns which were part of the stipulated record. There are no findings of fact supporting

this amount or any other amount of foreign withholding taxes paid. That amount does not appear on the face of the returns. How it was derived by Petitioner is not at all clear. The record is thus inadequate in establishing the amount of withholding taxes paid.

CONCLUSION

For the foregoing reasons the Petition should be denied.

Respectfully submitted,

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